

This letter answers a number of questions concerning the taxation of different lease charges and fees. See 86 Ill. Adm. Code 130.220. (This is a GIL).

July 26, 1999

Dear Ms. Xxxxx:

This letter is in response to PEROSN's letter dated May 24, 1999 which was received by our office on July 2, 1999. The nature of his letter and the information he has provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY respectfully requests your opinion as to the applicability of your State's Sales and Use Tax to the following situations:

- 1. Is the sales or use tax on the long term lease of motor vehicles to be remitted based on the purchase price of the vehicle or collected on the monthly rentals,**

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Rental charges for a sublease are also not subject to tax in Illinois. Consequently, lessees incur no tax liability.

Please note that Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the

lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. The Automobile Renting Occupation and Use Tax Act imposes a tax upon persons engaged in this State in the business of renting automobiles in Illinois under lease terms of one year or less at the rate of 5% of the gross receipts from such business. See the enclosed copy of 86 Ill. Adm. Code 180.101. Subsection (b) of Section 180.101 defines the term "automobile" for purposes of the Act and does not include commercial trucks, tractors, or trailers. Lessors of these types of vehicles are subject to Use Tax liability as discussed above.

- 2. COMPANY enters into a lease agreement to lease an automobile to a client in your State, one of the provisions of the contract provides for a late charge to be assessed and collected on any payments that are received late. Is the late payment charge subject to the Sales and Use tax in your State,**

As noted above in question number 1, the State of Illinois imposes no Retailers' Occupation Tax or Use Tax on rental receipts. Since a lessee incurs no Retailers' Occupation Tax or Use Tax liability on the lease of an automobile for a lease period in excess of one year, the lessee generally incurs no such tax liability on any related lease charges such as late payment fees, disposition fees, lease termination fees, acquisition fees, excess mileage fees, or fees for excess wear and tear, service fees, or legal fees.

- 3. Is your states sales or use tax applicable to vehicle trade ins and if so what is the basis for the application of tax,**

As noted above in true lease situations (other than those under the Automobile Renting Occupation and Use Tax Act), the lessors incur Use Tax on the purchase price of the vehicles. When the lease term ends, possession of the vehicle reverts back to the lessor. The lessors may then exercise several options with the vehicles, such as re-leasing the vehicles, selling the vehicles, or trading the vehicles in on other vehicles that will be leased. If a lessor trades the vehicle in on the purchase of another vehicle that it intends to lease, that lessor will receive a trade-in credit.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. The tax is measured by the seller's gross receipts from such sales made in the course of such business. See the enclosed copy of 86 Ill. Adm. Code 130.101. "Gross receipts" are considered to mean all the consideration actually received by the seller, except traded-in tangible personal property. See the enclosed copies of 86 Ill. Adm. Code 130.401 and

130.425. The traded-in item must be of like kind and character as that which is being sold. Please note that, since lessees under true leases do not own the leased property, they have no property to trade-in when seeking a new lease. The same rules apply to other types of tangible personal property. For your general information, we have also included a copy of 86 Ill. Adm. Code 130.455 concerning motor vehicle leasing and advance trade-in allowances.

4. Is your states sales or use tax applicable to a cash down payment,

We are unsure as to what the "cash down payment" is being applied to. If it is what a lessor is paying towards the purchase of a motor vehicle for lease, then it generally would be part of the gross receipts from the sale of that motor vehicle and would be subject to Retailer's Occupation Tax/Use Tax. If the down payment is part of what a lessee is paying the lessor in lease payments, then it is not subject to tax as part of the lease payments described in question number 1 above.

5. Is your states sales or use tax applicable to, an acquisition fee,

Please see the answer to question number 2 above.

6. Is your state sales or use tax applicable to, the Federal Luxury tax,

Federal luxury taxes may be deducted from the gross receipts from sales of tangible personal property that are subject to Retailers' Occupation Tax liability. See generally 86 Ill. Adm. Code 130.445.

7. Is your states sales or use tax applicable to, the purchase of Extended Warranty Contracts,

The taxability of service contracts or maintenance agreements (warranties) depends upon if the charges for those agreements are included in the selling prices of the tangible personal property. If such charges are included in the selling price, those charges are part of the gross receipts of the retail transactions and are subject to tax. If this is the case, no tax is incurred on the maintenance services or parts when the repairs or servicing is performed.

Alternatively, persons may sell service contracts or maintenance agreements as separate agreements for predetermined fees. In these transactions, the proceeds from the sale of such contracts or agreements are not subject to tax. However, servicemen who provide service under the separate maintenance agreements or service contracts incur Use Tax liability based on their cost price of the tangible personal property transferred incident to the completion of the maintenance agreements. See the enclosed copy of 86 Ill. Adm. Code 140.301(3)(b). Further, the purchaser of the separate agreement or warranty is not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance agreement. If a deductible is

charged to the purchaser under the terms of the separate agreement, the deductible is also not subject to tax.

If repairs are made which are not covered by or are outside of the terms and conditions of a maintenance agreement, repairmen making such repairs would generally be considered servicemen. Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of services. However, tangible personal property transferred incident to sales of service is subject to Service Occupation Tax liability. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e., servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. The servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

8. Is your states sales or use tax applicable to, rebates,

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. The tax is measured by the seller's gross receipts from such sales made in the course of such business. See the enclosed copy of 86 Ill. Adm. Code 130.101.

Gross receipts are defined as all the consideration actually received by the seller, except traded-in tangible personal property. See the enclosed copy of 86 Ill. Adm. Code 130.401. If sellers receive a reimbursement or rebate for a discount, the amount of that reimbursement or rebate is considered part of the gross receipts received by those sellers. This amount is fully taxable. An example is where a car dealer sells a vehicle for \$15,000 with a \$1,000 discount (with rebate or reimbursement to the dealer). The purchaser pays \$14,000 to the dealer and the dealer receives \$1,000 from the manufacturer. In this example, the dealer's total gross receipts of \$15,000 are subject to Retailers' Occupation Tax.

If sellers provide discounts to purchasers and do not receive a reimbursement or rebate for those discounts, only the (discounted) amounts received by those sellers are taxable. An example is where a car dealer sells a vehicle for \$15,000 with a \$1,000 discount (without rebate or reimbursement to the dealer). The purchaser pays \$14,000 to the dealer and the dealer receives no other consideration from any other source. In this example, the dealer's total gross receipts of \$14,000 are subject to Retailers' Occupation Tax.

For your general information we have also the enclosed copies of 86 Ill. Adm. Code Sections 130.420 (Discounts) and 130.2125 (Trading Stamps and Discount Coupons).

9. Is your states sales or use tax applicable to, parking tickets or other violations paid by the lessor and collected from the lessee,

The Retailers' Occupation Tax and Use Tax provisions apply to the sale of tangible personal property at retail for use in this state. Charges for parking tickets or similar parking or vehicle violations are not subject to Retailers' Occupation Tax and Use Tax.

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10. Is your states sales or use tax applicable to, excise or advalorem taxes collect from the lessee,

Generally, if the legal incidence of a tax (other than Retailers' Occupation Tax) is on the consumer and the retailer is merely acting as a collector of that tax, the amounts collected because of that tax are not considered to be a part of the retailer's gross receipts that are subject to Retailers' Occupation Tax liability. See the enclosed copies of 86 Ill. Adm. Code 130.435 and 130.445.

11. Is your states sales or use tax applicable to, service fees collected from the lessee,

12. Is your states sales or use tax applicable to, early lease termination fees collected from the lessee,

13. Is your states sales or use tax applicable to, vehicle disposition fees paid by the lessor and collected from the lessee,

14. Is your states sales or use tax applicable to, excess mileage fees collected from the lessee,

15. Is your states sales or use tax applicable to, vehicle damage fees collected from the lessee,

16. Is your states sales or use tax applicable to, legal fees collected from the lessee?

For answers to question numbers 11 through 16, see the answer to question number 2 above.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.